

# **Texas Two-Step: Dancing Through Real Estate Referrals**

Real estate referrals in Texas come with legal boundaries and ethical responsibilities.

**BY KERRI LEWIS**



# TEXAS TWO-STEP

## Dancing Through Real Estate Referrals



### Real estate referrals in Texas come with legal boundaries and ethical responsibilities.

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Referrals are common in the real estate industry. In Texas, if the referral involves the payment of a fee or other valuable consideration for the introduction of business, Texas Real Estate Commission (TREC) laws and regulations come into play.

In particular, there are three types of referrals that TREC regulates: license holder to license holder, client to license holder, and license holder to another service provider.



### License Holder to License Holder

Texas law requires that any individual or entity expecting to receive valuable consideration for a real estate referral must hold an active Texas real estate license at the time the referral is made. This requirement comes from 22 Texas Occupations Code §1101.002, which defines “broker” to include a person who, for compensation, “procures or assists in procuring a prospect to effect the sale, exchange, or lease of real estate.” In this way, the state ensures that individuals who make referrals for financial gain adhere to regulatory competency and ethical standards. Failure to comply with this licensure requirement can result in administrative action against both the unlicensed individual receiving a referral fee and the license holder who paid the referral fee. The unlicensed individual could be charged with unlicensed activity, a class A misdemeanor, or TREC can issue a cease-and-desist order (TREC Rule

535.181). It’s important to point out that a license holder on inactive status cannot receive referral fees if the referral was made while they were on inactive status.

Ethical considerations are paramount in all aspects of real estate practice, including referrals. Under TREC rules, Texas real estate license holders have an ethical duty to act in the best interest of their clients and this principle should guide all referral decisions. The first decision to be considered is: When should a license holder refer a client to another license holder? Prioritizing a client’s needs over their own personal gain requires a license holder to evaluate whether they possess the necessary skills, property type experience, and local market knowledge to effectively represent the client. If not, the license holder should use due diligence to select another license holder who is competent, reputable, and well suited to represent the client’s best interests. Remember, as the adage goes, it’s better to receive a referral fee than pay the deductible on your errors and omissions insurance policy.

While it is perfectly ethical to negotiate a fee for a referral, the referring license holder should prioritize the client's needs over the amount of any potential referral fee. Although not required by law, referral fees between license holders *should* be disclosed to the client. This ensures transparency and will help maintain a future relationship with the client.

Once the referring license holder has located a competent license holder to refer to their client, the typical referral process involves discussing the referral fee upfront, obtaining a written agreement, connecting the client with the referred license holder, tracking the progress of the transaction, and, finally, the receiving brokerage paying the referral fee to the referring brokerage on successful closing. A written referral agreement is a best practice and should include all the terms of the arrangement, including the license holders' identities, the referral fee percentage or amount, when it is payable, the client being referred, and the duration of the agreement.

Referral fees are typically a percentage of the commission earned by the license holder who received the referral at closing of the transaction. Although fully negotiable, referral fees generally range between 20 percent to 35 percent of the total commission. Like any other real estate brokerage compensation, TREC rules require that all referral fees paid to sales agents must be paid through their sponsoring broker and not directly from one sales agent to another. Therefore, sales agents should always seek the approval of their sponsoring broker before offering or agreeing to accept a referral fee. This ensures proper oversight and compliance with broker policies and TREC regulations.



## Client to License Holder

Recommendations from previous clients are one of the best ways for a license holder to build their business, and most clients willingly recommend an agent who has done a great job. However, if the former client wants to get paid for making referrals, they would be engaging in the unlicensed practice of real estate brokerage and subject to criminal prosecution initiated by TREC. Any license holder paying such a referral fee could also be subject to sanctions by TREC.

However, the state of Texas recognizes that license holders may want to reward faithful clients in some way for referrals, and TREC adopted Rule §535.20 in 1976 to provide a way for license holders to give unlicensed individuals nominal "payments." By defining what constitutes "valuable consideration" in the context of referrals, the rule carves out some limited exceptions that can be given. Under this rule, a license holder may give an unlicensed person a gift or a gift card worth up to \$50. The gift card must be redeemable only for merchandise and cannot be a bank gift card that is convertible to cash.

This may seem like a straightforward rule, but license holders over the years have been creative in looking for ways to give unlicensed individuals more for their referrals. Here are some examples and the limitations applied to them:

1. A license holder gives unlicensed people a raffle ticket for a drawing to win a cruise to Cozumel at the end of the year. On the surface, giving an unlicensed person a raffle ticket worth less than \$50 may look like it fits under TREC Rule §535.20, but it does not. While the majority of unlicensed people who receive raffle tickets are not being given anything of value over \$50, the person who ultimately wins the raffle will receive something of value in excess of \$50, so this scheme has been held to violate TREC's rule.
2. If a license holder donates a portion of their commission to a non-profit organization, such as a church or school, for each referral received, the person making the referral may not receive anything defined as "valuable consideration" under the rule from the organization or the license holder. For example, a donation to the school's band travel fund following a referral by a band member's parent, would be considered valuable consideration to the referring parent since the travel fund benefits the referring parent's child.
3. A landlord offers tenants a \$40 deduction in next month's rent for each referral received that results in a new lease. This violates the rule since it is considered cash or cash equivalent. Even though it's less than \$50, any amount of cash or a credit or bonus toward rent owed is

also not allowed as a reward for a referral. Rent bonuses and discounts are specifically named in the rule as "valuable consideration."



## Between License Holders and Other Businesses

TREC Rule §535.20 also acknowledges that referrals can occur as a natural extension of other business activities without an intention of engaging in unlicensed real estate brokerage. The rule provides that a person engaged in the business of selling goods or services to the public is not required to hold a real estate license if they refer their customers to a real estate license holder *after* selling them goods or services, provided the payment for these goods or services is *not contingent* on the consummation of a real estate transaction.

If the other business is a settlement service provider, referral payments are not permitted. In September of 2019, TREC made amendments to Rule §535.148 specifically targeting and prohibiting "pay-to-play" arrangements related to referrals of settlement service providers such as inspectors, lenders, and title companies. An example of pay-to-play would be if a brokerage firm charged inspectors a fee to be included on their referral list and then provided that list to their clients. These changes sought to strengthen the independence of the service providers and enhance consumer protection by ensuring referrals to settlement service providers were based on merit and not who paid to be put on a list.

Finally, license holders involved in referral fee arrangements with other non-settlement service provider businesses have a specific disclosure requirement in §535.148 to ensure transparency to clients. The rule provides that the license holder may not receive a commission, rebate, or fee from a person other than the person they represent without first disclosing this to their client and obtaining their consent. However, the rule also provides a specific exception for referral fees paid between actively licensed real estate brokers and agents. **TG**



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